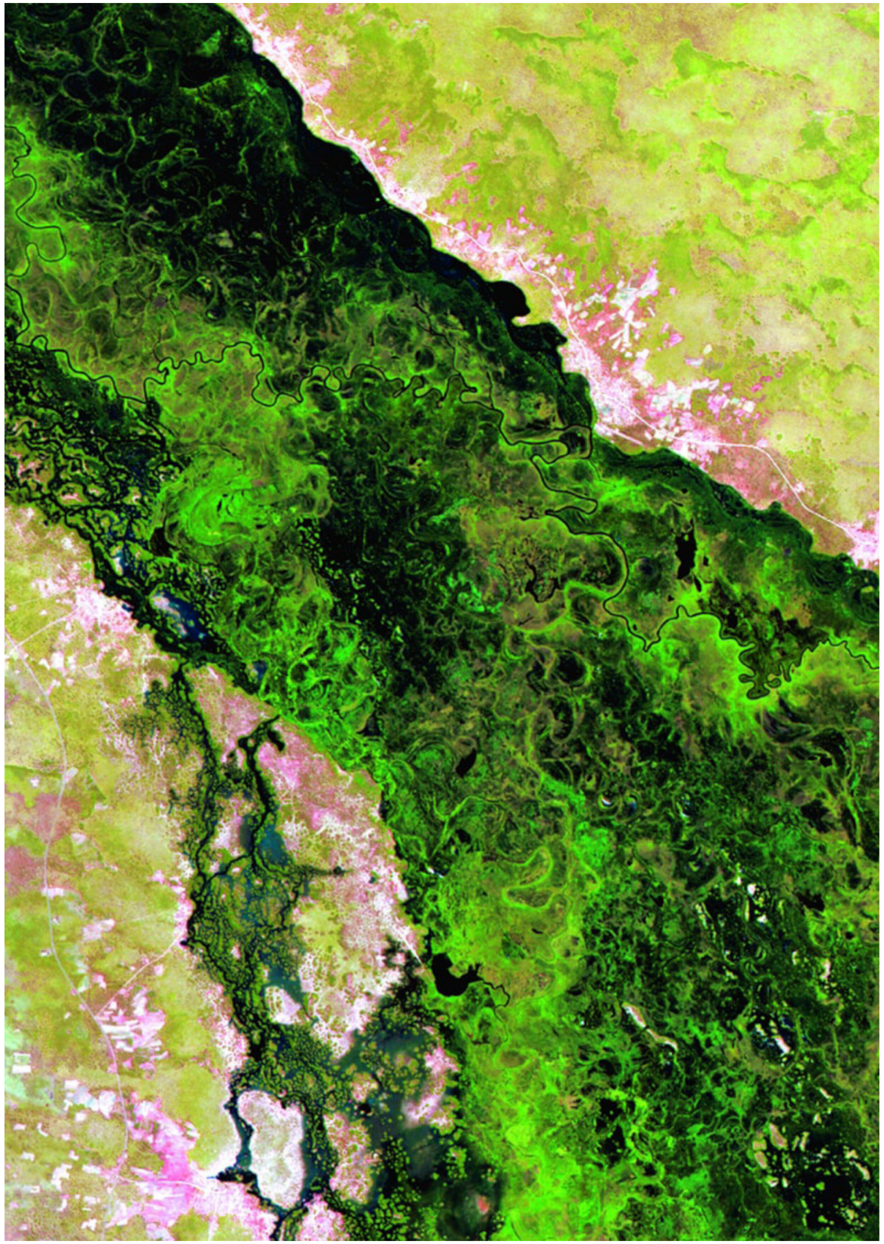

Centre for Sustainable Finance
SOAS University of London

Global Development Policy Center

HEINRICH BÖLL STIFTUNG

Debt Relief for a Green and Inclusive Recovery: Securing Private-Sector Participation and Policy Space for Sustainable Development


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Debt Relief for a Green and Inclusive Recovery

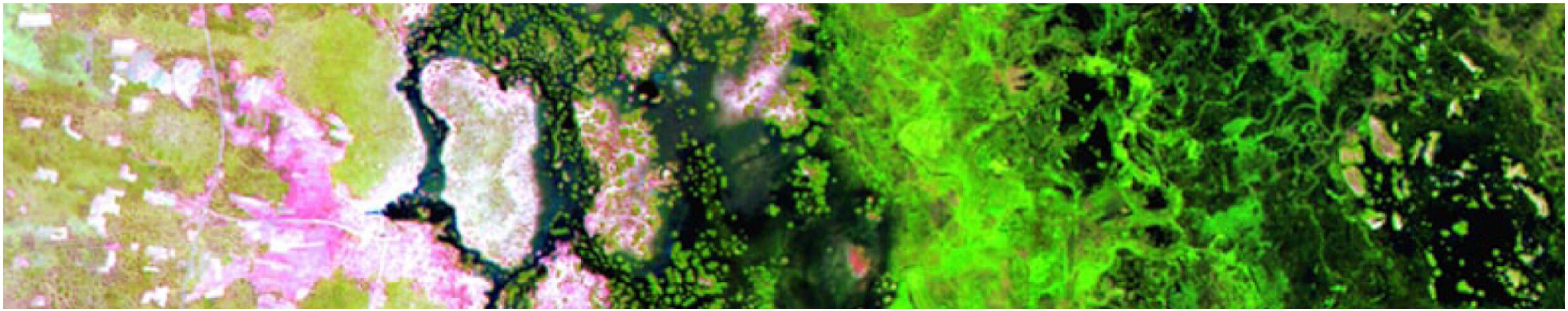
A Proposal

November 2020

- In November 2020, we put forward an ambitious proposal for a debt relief for a green and inclusive recovery.
    - Would not only apply to LICs, but also to MICs that have been hit hard by the pandemic.
    - Highlighted the importance of linking debt restructuring with the need to build resilience and a commitment by creditors and debtor countries alike to align newfound fiscal space with globally agreed climate and development goals.
- In our new report, we develop this proposal further.

Outline

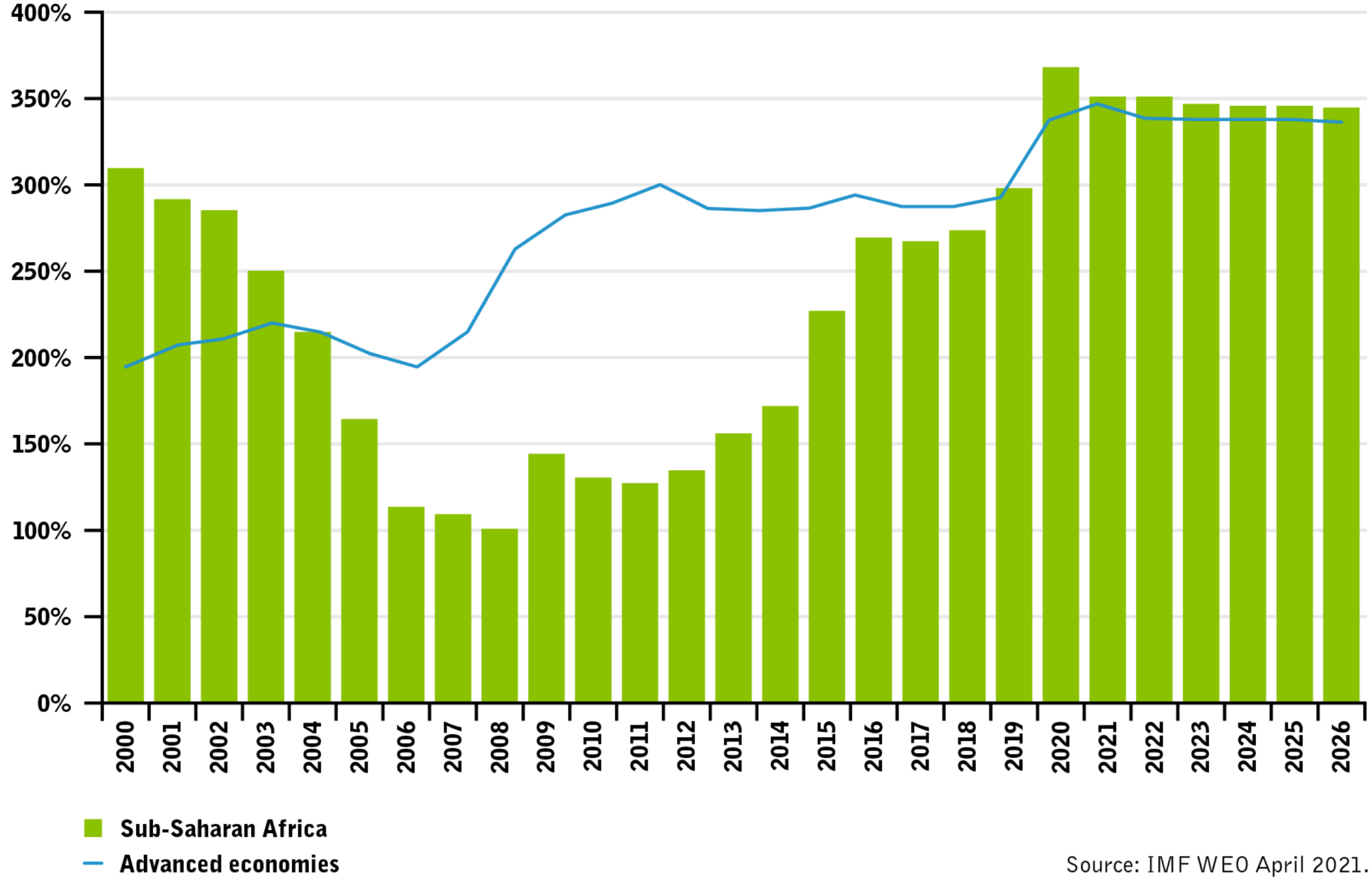
- The Calm before the Storm: A Debt Crisis Is Looming
- Debt Sustainability Analysis: Getting it Right
- Creating Incentives for Private Sector Participation
- How to Link Debt Relief to a Green and Inclusive Recovery
- The Way Forward



The Calm before the Storm: A Debt Crisis Is Looming

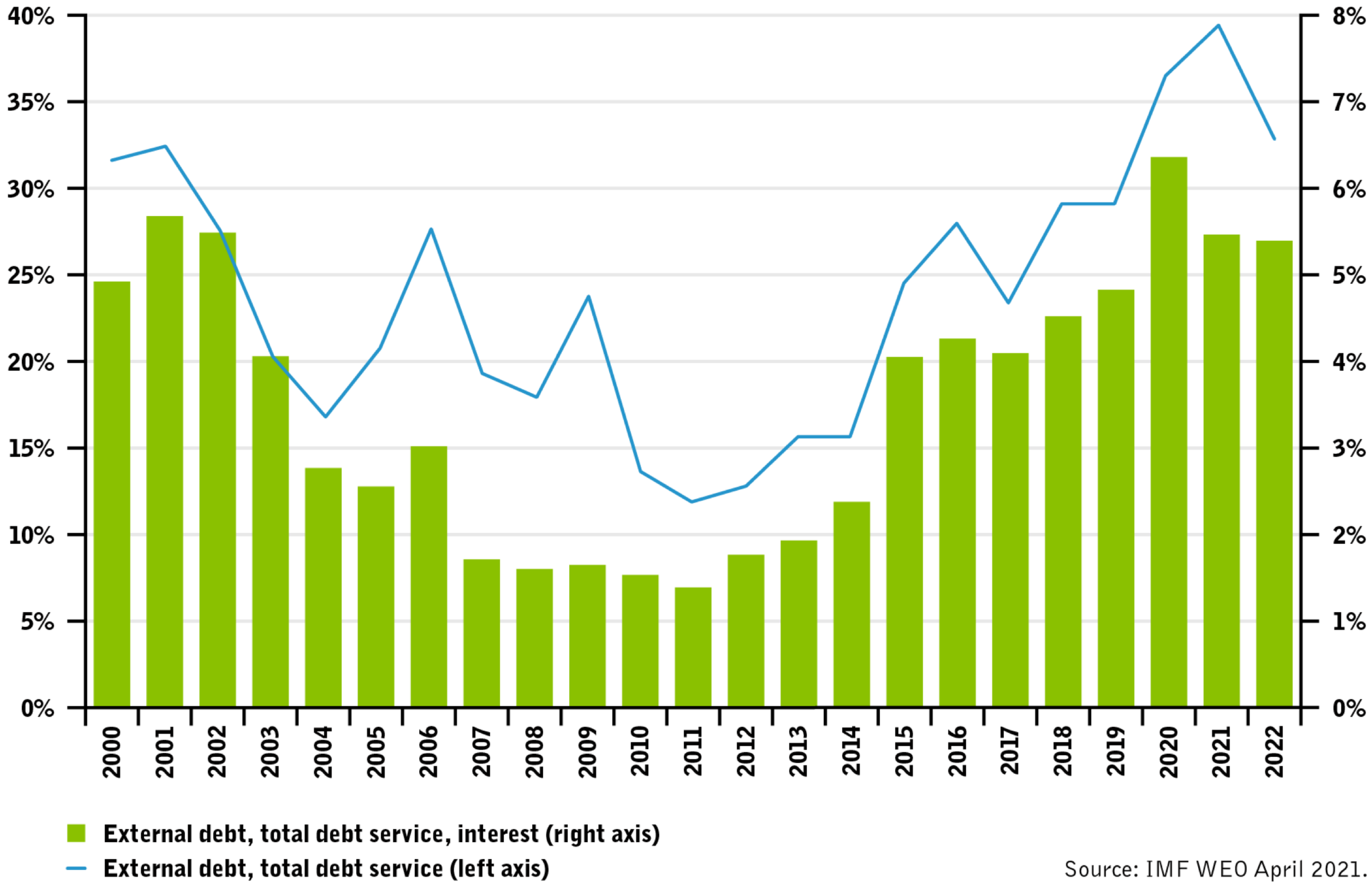
- Since the heights of financial market turmoil and the large-scale withdrawal of international capital from developing and emerging economies at the outbreak of the Covid-19 crisis, markets have stabilised.
- The rise in commodity prices and more favourable bond market conditions may provide temporary relief.
- But risks continue to loom large, and for some countries a new round of debt issuances may further undermine debt sustainability.
- The IMF is concerned that the recovery in advanced economies may lead to overheating and subsequent interest rate hikes that could trigger capital outflows and exchange rate depreciations that could balloon already concerning levels of external debt across the developing world.

Sub-Saharan Africa: Public debt as % of revenues



Source: IMF WEO April 2021.

Sub-Saharan Africa: External debt service (% of exports)



Source: IMF WEO April 2021.

- Protracted recoveries due to insufficient fiscal stimulus and slow progress in vaccinations will undermine development prospects in the Global South.
- Already now, high debt service levels are impeding crisis responses and threatening the achievement of the SDGs.
- In many developing and emerging countries, external public debt service is larger than healthcare and education expenditure taken together.
- High debt service levels are crowding out the room for crucial investments in climate resilience.
    - Insufficient amounts of investment in climate adaptation and resilience will undermine both development prospects and public finances.
    - Countries that fail to climate-proof their economies and public finances face an ever-worsening spiral of climate vulnerability and unsustainable debt burdens.

Debt Sustainability Analysis: Getting it Right

- Current DSAs are not fit for the job and need to be substantially revamped.
  - DSAs have been criticised for being based on overly optimistic scenarios and underestimating risks.
  - To date, DSAs do not include climate or other sustainability risks, nor do they account for crucial investment needs for climate adaptation or achieving the SDGs.
- DSAs need to be based on realistic assumptions and account for climate risks and spending needs to scale-up investment in climate resilience, the transition to a green economy, and Agenda 2030.
- Eligibility for debt relief should be determined in a substantially enhanced DSA carried out by the IMF and the World Bank in close partnership with the debtor government, with inputs from other institutions.

Creating Incentives for Private Sector Participation

- If a DSA asserts that a country's sovereign debt is of significant concern, the IMF needs to make potential new programmes conditional on a restructuring process that includes private creditors.
- Debtor countries that seek bilateral haircuts will be required to seek commensurate relief from private creditors.
- Incentives need to be designed to ensure that private creditors grant such relief.
  - To secure the participation of private creditors in debt restructuring, these need to be convinced that participation is better than abstention.

Carrots and sticks

- Guaranteeing restructured debt through a Guarantee Facility for Green and Inclusive Recovery:
  - Located at the World Bank.
  - The Facility will back the payments of newly issued sovereign bonds that will be swapped with a significant haircut for old and unsustainable debt.
  - The Facility will provide a partial guarantee of the principal, as well as a guarantee on 18 months' worth of interest payments.
- Regulatory incentives and moral suasion:
  - In the past, moral suasion and regulatory tools have been used to incentivise commercial participation in restructurings.
  - Along with the IMF, the financial authorities of the major advanced economies and China, as well as those of other major financial centres, could play a critical role in getting commercial creditors to accept and implement debt reduction.

How to Link Debt Relief to a Green and Inclusive Recovery

- Debt relief should not only provide temporary breathing space.
- It should empower governments to lay the foundations for sustainable development by investing in strategic areas of development, including health, education, digitisation, cheap and sustainable energy, and climate-resilient infrastructure.
- An agreement on debt restructuring would require debtor countries to commit to reforms that align their policies and budgets with Agenda 2030 and the Paris Agreement.
- The country commitments would be designed by country governments under the involvement of the parliaments and in consultation with the relevant stakeholders.
  - They should not be imposed on them by the global community.
  - They should reflect the needs and priorities of each country.

Debtor governments advance their own Green and Inclusive Recovery Strategy (GIRS)

- It should build on countries' already existing national strategies, plans, and visions.
- It should be a short document that highlights the government's policy priorities for the recovery, along with a set of key performance indicators that it seeks to achieve.
- It should include a spending plan.
- It should be guided by a set of principles that ensure that the recovery is in line with Agenda 2030 and the Paris Agreement.

Principles for a green and inclusive recovery

1. **Policies and spending should be directed towards supporting green and inclusive recoveries, in line with the SDGs set out in the Agenda 2030, and with the goals of the Paris Agreement.**

2. **No public money or guarantee should be used to finance the development of new fossil fuel supply.**

3. **Fossil fuel subsidies should be shifted towards the provision of clean and affordable energy.**

4. **The recovery should not diminish the integrity of a country's ecosystems but maintain its biodiversity in line with global biodiversity targets.**

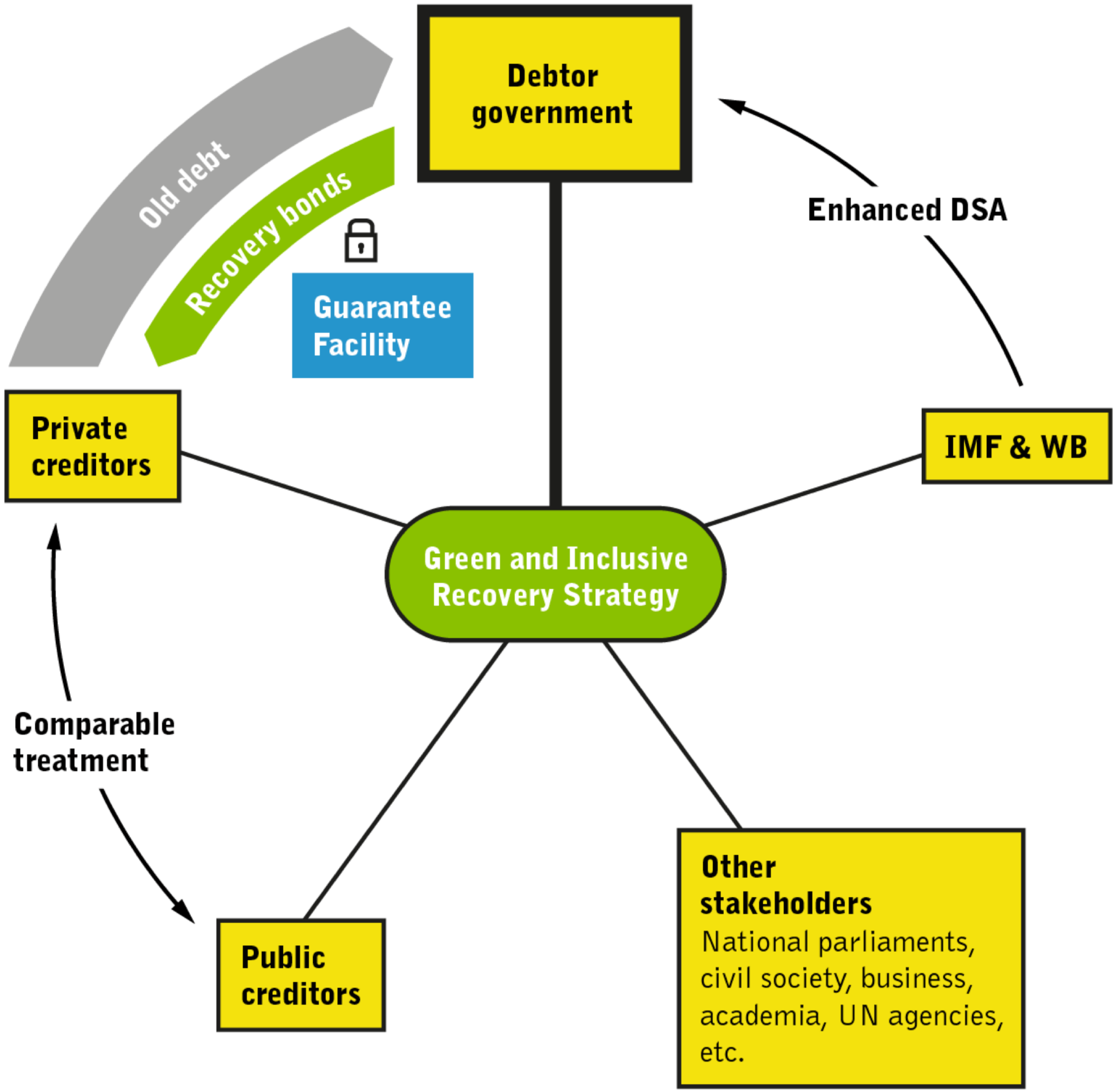
5. **Measures and policies should contribute to enhancing the overall resilience of the society and economy so they are better prepared for a volatile future.**

6. **Public policies should ensure that the low-carbon transition is a just one.**

2030	**Substainable Development Goals**
2050	**Net-zero**

- The draft GIRS would undergo a public and transparent consultation process facilitated by an independent mediator.
  - Should involve all relevant national stakeholders, in particular the parliament, but also civil society and academia, as well as international stakeholders (incl. bilateral and private creditors, the World Bank and regional development banks, the IMF, and UN agencies).
  - Should ensure that the GIRS reflects and achieves the development needs and aspirations of the debtor country, and that it is informed by the latest scientific knowledge regarding the unfolding sustainability crisis.
- The debtor-country government would revise the GIRS based on feedback from this consultation process.
- The GIRS will form the basis for a debt restructuring to which debtor government and public and private creditors agree.

- The envisaged spending under the GIRS would be sourced from a Fund for Green and Inclusive Recovery, into which a portion of the restructured repayments would be channelled.
    - Alternatively, an already existing national fund could be used.
- The government will be free to decide how to spend the money from this Fund, as long as it is in line with the goals set out in the GIRS.
- A steering group would monitor implementation.
- Governments would also commit to enhancing debt transparency, adopting sustainable borrowing practices and to strengthening public debt management capacity and domestic resource mobilization.


Debtor government
Old debt
Recovery bonds
Guarantee Facility
Enhanced DSA
Private creditors
IMF & WB
Green and Inclusive Recovery Strategy
Comparable treatment
Public creditors
Other stakeholders
National parliaments, civil society, business, academia, UN agencies, etc.

The Way Forward

- The debt situation is already constraining recoveries and investment in sustainable development.
- It is likely to escalate in many countries when suspended debt payments are due and interest rates in the US will start to rise.
- Now is the time to tackle the looming debt crisis.
- Delaying an inevitable debt restructuring will leave overindebted countries and their populations worse off.
- It is time for the G20 to step up and provide all countries with the opportunity to pursue a green, inclusive, and resilient recovery.

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June 2021